

AMENDED IN SENATE JULY 3, 2003
AMENDED IN ASSEMBLY MAY 19, 2003
AMENDED IN ASSEMBLY APRIL 10, 2003

CALIFORNIA LEGISLATURE—2003–04 REGULAR SESSION

ASSEMBLY BILL

No. 1601

Introduced by Assembly Member Frommer

February 21, 2003

An act to amend Sections ~~18628, 19057, 19164, 19177, and 19182~~ 19164, 19166, 19173, 19177, 19179, 19715, and 21028 of, to add Section 18407 to, and to add Chapter 9.5 (commencing with Section 19770) to Part 10.2 of, the Revenue and Taxation Code, relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

AB 1601, as amended, Frommer. Administration of taxes: tax shelters: penalties.

Existing law imposes various taxes and fees, and certain penalties on late payments of those taxes and fees. Existing law provides specified conformity to federal income tax laws with respect to penalties imposed in connection with tax avoidance and abusive tax shelters.

This bill would, in modified conformity with federal income tax laws, increase the penalties imposed with respect to tax avoidance and abusive tax shelters, as provided.

~~Existing law requires that a tax shelter organized in California be subject to the California registration requirements.~~

~~This bill would impose the same registration requirements on tax shelters that are organized outside California but are doing business in~~

~~California, deriving income from California, soliciting California taxpayers to invest, or have California investors.~~

~~Existing law imposes various taxes and fees, and certain penalties and interest on late payments of those taxes and fees, and authorizes the Franchise Tax Board to make a deficiency assessment and to mail a notice of proposed deficiency assessment to a taxpayer, generally, within 4 years after the return required to be filed by the taxpayer is filed.~~

~~This bill would extend the statute of limitations applicable to the assessment of any deficiency by the Franchise Tax Board to 8 years in the case of any return filed on or after January 1, 2000, by a taxpayer who is an investor in a tax shelter, as defined.~~

~~Existing law imposes an accuracy-related penalty on any portion of an underpayment of tax required to be shown on a return. The amount of that penalty is determined by reference to the federal income tax law, and generally equals 20% of the amount of the underpayment of tax.~~

~~This bill, with respect to the underpayment of tax by a taxpayer who is an investor in a tax shelter, as defined, would increase the amount of that penalty to 50% of the amount of the underpayment.~~

~~Existing law provides specified conformity to federal income tax law with respect to penalties imposed on promoters or organizers of abusive tax shelters.~~

~~This bill would modify the federal income tax law provisions, as applied for purposes of the Personal Income Tax and the Corporation Tax Laws, to increase the amount of penalty imposed for promoting abusive tax shelters to 25% of the aggregate amount invested in the tax shelter.~~

~~Existing law requires an organizer of a tax shelter that is organized in California to furnish to the Franchise Tax Board a duplicate of the registration information required to be submitted to the Secretary of the Treasury. Existing law also imposes a penalty, by reference to the federal income tax laws, for failure to send a duplicate of the registration information to the Franchise Tax Board.~~

~~This bill would increase the amount of that penalty to 25% of the aggregate amount invested in the tax shelter.~~

~~Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.~~

The people of the State of California do enact as follows:

1 ~~SECTION 1.—Section 18628 of the Revenue and Taxation~~

2 *SECTION 1. Section 18407 is added to the Revenue and*
3 *Taxation Code, to read:*

4 18407. *Section 6011 of the Internal Revenue Code, relating to*
5 *general requirement of return, statement, or list, applies, except as*
6 *otherwise provided.*

7 (a) *Section 6011(a) of the Internal Revenue Code, relating to*
8 *general rule, is modified as follows:*

9 (1) *The phrase “Any person liable for any tax imposed by the*
10 *Personal Income Tax Law (Part 10 (commencing with Section*
11 *17001)), the Corporation Tax Law (Part 11 (commencing with*
12 *Section 23001)) or this part,” is substituted for the phrase “When*
13 *required by regulations prescribed by the Secretary any person*
14 *made liable for any tax imposed by this title”.*

15 (2) *“Secretary of the Treasury under Section 6011 of the*
16 *Internal Revenue Code for federal income tax purposes or by the*
17 *Franchise Tax Board” is substituted for “Secretary.”*

18 (3) *To additionally provide that “reportable transaction” (as*
19 *defined in paragraph (1) of subdivision (c) of Section 19772)*
20 *includes any transaction of a type that the Secretary of the Treasury*
21 *under Section 6011 of the Internal Revenue Code for federal*
22 *income tax purposes or the Franchise Tax Board determines as*
23 *having a potential for tax avoidance or evasion, including*
24 *deductions, basis, credits, entity classification, dividend*
25 *elimination, or omission of income, and shall be reported on the*
26 *return or statement required to be made.*

27 (4) *To additionally provide that “listed transaction” (as*
28 *defined in paragraph (2) of subdivision (c) of Section 19772)*
29 *includes any transaction that is the same as, or substantially*
30 *similar to, a transaction specifically identified by the Secretary of*
31 *the Treasury under Section 6011 of the Internal Revenue Code for*
32 *federal income tax purposes or by the Franchise Tax Board, as a*
33 *tax avoidance transaction, including deductions, basis, credits,*
34 *entity classification, dividend elimination, or omission of income*
35 *and shall be reported on the return or statement required to be*
36 *made.*

37 (A) *The Franchise Tax Board shall identify and publish “listed*
38 *transactions” (whether identified by the Secretary of the Treasury*

1 under Section 6011 of the Internal Revenue Code for federal
2 income tax purposes or by the Franchise Tax Board) through the
3 use of Franchise Tax Board Notices or other published positions.
4 In addition, the “listed transactions” identified and published
5 pursuant to the preceding sentence shall be published on the Web
6 site of the Franchise Tax Board.

7 (B) The Franchise Tax Board shall conduct a public outreach
8 program to make taxpayers aware of the new and increased
9 penalties associated with the use of tax avoidance transactions,
10 including deductions, basis, credits, entity classification, dividend
11 elimination, or omission of income.

12 (5) Chapter 3.5 (commencing with Section 11340) of Part 1 of
13 Division 3 of Title 2 of the Government Code does not apply to any
14 standard, criterion, procedure, determination, rule, notice, or
15 guideline established or issued by the Franchise Tax Board
16 pursuant to paragraph (3) or (4).

17 (b) Section 6011(b) of the Internal Revenue Code, relating to
18 identification of taxpayer, does not apply and, in lieu thereof,
19 Section 18408 applies.

20 (c) Section 6011(c) of the Internal Revenue Code, relating to
21 returns, etc., of DISCS and former DISCS and FSC’s and former
22 FSC’s, does not apply.

23 (d) Section 6011(d) of the Internal Revenue Code, relating to
24 authority to require information concerning Section 912
25 allowances, does not apply.

26 (e) Section 6011(e) of the Internal Revenue Code, relating to
27 regulations requiring returns on magnetic media, etc., shall take
28 into account Section 18408 and shall also include the
29 modifications made to Section 6011(e) of the Internal Revenue
30 Code by Section 18408.

31 (f) Section 6011(f)(2) of the Internal Revenue Code, relating to
32 incentives, does not apply.

33 SEC. 2. Section 19164 of the Revenue and Taxation Code is
34 amended to read:

35 19164. (a) (1) An accuracy-related penalty shall be imposed
36 under this part and shall be determined in accordance with ~~the~~
37 ~~provisions of~~ Section 6662 of the Internal Revenue Code, relating
38 to imposition of accuracy-related penalty, *except as otherwise*
39 *provided*.

(2) With respect to corporations, this subdivision ~~shall apply~~
applies to all of the following:

(A) All taxable years beginning on or after January 1, 1990.

(B) Any other taxable year for which an assessment is made
after July 16, 1991.

(C) For purposes of this section, references in Section 6662(e)
of the Internal Revenue Code and the regulations thereunder,
relating to treatment of an affiliated group that files a consolidated
federal return, are modified to apply to those entities required to
be included in a combined report under Section 25101 or 25110.
For these purposes, entities included in a combined report pursuant
to paragraph (4) or (6) of subdivision (a) of Section 25110 shall be
considered only to the extent required to be included in the
combined report.

(3) *Section 6662(d)(1)(B) of the Internal Revenue Code is
modified to provide that in the case of a corporation, other than an
“S” corporation, there is a substantial understatement of tax for
any taxable year if the amount of the understatement for the
taxable year exceeds the lesser of:*

(A) *Ten percent of the tax required to be shown on the return for
the taxable year (or, if greater, two thousand five hundred dollars
(\$2,500)).*

(B) *Five million dollars (\$5,000,000).*

(4) *Section 6662(d)(2)(A) of the Internal Revenue Code is
modified to provide that the excess determined under Section
6662(d)(2)(A) of the Internal Revenue Code shall be determined
without regard to items to which Section 19773 applies and
without regard to items with respect to which a penalty is imposed
by Section 19774.*

(5) *Section 6662(d)(2)(B)(i) of the Internal Revenue Code is
modified to substitute the phrase “the tax treatment of any item by
the taxpayer if the taxpayer had reasonable belief that the tax
treatment was more likely than not the proper treatment” for the
phrase “the tax treatment of any item by the taxpayer if there is or
was substantial authority for such treatment” contained therein.*

~~(b) The modifications to Section 6662 of the Internal Revenue
Code by Public Law 103-66 and Public Law 103-465 shall apply
with respect to returns filed for taxable years beginning on or after
January 1, 1997.~~ (1) *For purposes of Section 6662(d) of the
Internal Revenue Code, Section 6664 of the Internal Revenue*

1 Code (as modified by subdivision (d)), Section 6694(a)(1) of the
2 Internal Revenue Code, and this part, the Franchise Tax Board
3 may prescribe a list of positions for which the Franchise Tax Board
4 believes there is no substantial authority or there is no reasonable
5 belief that the tax treatment is more likely than not the proper tax
6 treatment. That list, and any revisions thereof, shall be published
7 through the use of Franchise Tax Board Notices or other published
8 positions. In addition, the “listed transactions” identified and
9 published pursuant to the preceding sentence shall be published on
10 the Web site of the Franchise Tax Board.

11 (2) Chapter 3.5 (commencing with Section 11340) of Part 1 of
12 Division 3 of Title 2 of the Government Code does not apply to any
13 standard, criterion, procedure, determination, rule, notice, or
14 guideline established or issued by the Franchise Tax Board
15 pursuant to paragraph (1).

16 (c) A fraud penalty shall be imposed under this part and shall
17 be determined in accordance with the provisions of Section 6663
18 of the Internal Revenue Code, relating to imposition of fraud
19 penalty, except as otherwise provided.

20 (d) ~~The provisions of Section 6664 of the Internal Revenue~~
21 ~~Code, relating to definitions and special rules, shall apply~~ applies,
22 except as otherwise provided.

23 (1) Section 6664 of the Internal Revenue Code is modified to
24 provide that no penalty shall be imposed under Section 19773 with
25 respect to any portion of a reportable transaction understatement
26 if it is shown that there was a reasonable cause for that portion and
27 that the taxpayer acted in good faith with respect to that portion.

28 (2) Paragraph (1) does not apply to any reportable transaction
29 understatement unless all of the following requirements are met:

30 (A) (i) The relevant facts affecting the tax treatment of the item
31 are adequately disclosed in accordance with the regulations
32 prescribed under Section 6011 of the Internal Revenue Code, as
33 modified by Section 18407.

34 (ii) A taxpayer failing to adequately disclose in accordance
35 with Section 6011 of the Internal Revenue Code, as modified by
36 Section 18407, shall be treated as meeting the requirements of this
37 subparagraph if the penalty for that failure was rescinded under
38 subdivision (d) of Section 19772.

39 (B) There is or was substantial authority for that treatment.

1 (C) *The taxpayer reasonably believed that that treatment was*
2 *more likely than not the proper treatment.*

3 (3) *For purposes of subparagraph (C) of paragraph (2), all of*
4 *the following apply:*

5 (A) *A taxpayer shall be treated as having a reasonable belief*
6 *with respect to the tax treatment of an item only if that belief meets*
7 *both of the following requirements:*

8 (i) *Is based on the facts and law that exist at the time the return*
9 *of tax that includes that tax treatment is filed.*

10 (ii) *Relates solely to the taxpayer's chances of success on the*
11 *merits of that treatment and does not take into account the*
12 *possibility that the return will not be audited, that the treatment*
13 *will not be raised on audit, or that the treatment will be resolved*
14 *through settlement if it is raised.*

15 (B) (i) *An opinion of a tax advisor may not be relied upon to*
16 *establish the reasonable belief of a taxpayer if either of the*
17 *following conditions are met:*

18 (I) *The tax advisor is described in clause (ii).*

19 (II) *The opinion is described in clause (iii).*

20 (ii) *A tax advisor is described in this clause if the tax advisor*
21 *meets any of the following conditions:*

22 (I) *Is a material advisor (within the meaning of paragraph (1)*
23 *of subdivision (b) of Section 19775) who participates in the*
24 *organization, management, promotion, or sale of the transaction*
25 *or who is related (within the meaning of Sections 267(b) or*
26 *707(b)(1) of the Internal Revenue Code) to any person who so*
27 *participates.*

28 (II) *Is compensated directly or indirectly by a material advisor*
29 *with respect to the transaction.*

30 (III) *Has a fee arrangement with respect to the transaction that*
31 *is contingent on all or part of the intended tax benefits from the*
32 *transaction being sustained.*

33 (IV) *As determined under regulations prescribed by either the*
34 *Secretary of the Treasury for federal income tax purposes or the*
35 *Franchise Tax Board, has a continuing financial interest with*
36 *respect to the transaction.*

37 (iii) *For purposes of clause (i), an opinion is disqualified if the*
38 *opinion meets any of the following conditions:*

39 (I) *Is based on unreasonable factual or legal assumptions*
40 *(including assumptions as to future events).*

1 (II) Unreasonably relies on representations, statements,
2 findings, or agreements of the taxpayer or any other person.

3 (III) Does not identify and consider all relevant facts.

4 (IV) Fails to meet any other requirement as either the Secretary
5 of the Treasury for federal income tax purposes or the Franchise
6 Tax Board may by forms and instructions prescribe.

7 (e) ~~The provisions of~~ Section 6665 of the Internal Revenue
8 Code, relating to applicable rules, ~~shall apply~~ applies, except as
9 otherwise provided.

10 (f) Section 461(i)(3)(C) of the Internal Revenue Code is
11 modified by substituting the phrase “Section 1274(b)(3)(B) of the
12 Internal Revenue Code, as modified by subdivision (g) of Section
13 19164” in lieu of “section 6662(d)(2)(C)(iii).”

14 (g) Section 1274(b)(3)(B)(i) of the Internal Revenue Code is
15 modified to provide that, for purposes of Section 1274(b)(3)(B) of
16 the Internal Revenue Code, the term “tax shelter” means (1) a
17 partnership or other entity, (2) any investment plan or
18 arrangement, or (3) any other plan or arrangement, if a significant
19 purpose of the partnership, entity, plan, or arrangement is the
20 avoidance or evasion of federal income tax or the tax imposed
21 under the Personal Income Tax Law (Part 10 (commencing with
22 Section 17001)) or Corporation Tax Law (Part 11 (commencing
23 with Section 23001)).

24 SEC. 3. Section 19166 of the Revenue and Taxation Code is
25 amended to read:

26 19166. A penalty shall be imposed for understatement of any
27 taxpayer’s liability by a tax return preparer. The penalty shall be
28 determined in accordance with Section 6694 of the Internal
29 Revenue Code, except ~~that~~ as otherwise provided.

30 (a) (1) Section 6694(a) of the Internal Revenue Code is
31 modified to substitute “\$1,000” in lieu of “\$250.”

32 (2) Section 6694(a)(1) of the Internal Revenue Code is
33 modified to substitute the phrase “reasonable belief that the tax
34 treatment in that position was more likely than not the proper
35 treatment” in lieu of the phrase “realistic possibility of being
36 sustained on its merits.”

37 (3) Section 6694(a)(3) of the Internal Revenue Code is
38 modified to substitute the phrase “or there was no reasonable basis
39 for the tax treatment of that position” in lieu of the phrase “or was
40 frivolous.”

1 (b) Section 6694(b) of the Internal Revenue Code is modified
2 to substitute "\$5,000" in lieu of "\$1,000."

3 (c) Section 6694(c) of the Internal Revenue Code ~~shall not be~~
4 ~~applicable~~ does not apply and, in lieu thereof, the following ~~shall~~
5 apply:

6 ~~(a)–~~

7 (1) If, within 30 days after the day on which notice and demand
8 of any penalty under Section 6694(a) or 6694(b) of the Internal
9 Revenue Code is made against any person who is an income tax
10 return preparer, that person pays an amount which is not less than
11 15 percent of the amount of that penalty and files a claim for refund
12 of the amount so paid, no levy or proceeding in court for the
13 collection of the remainder of that penalty shall be made, begun,
14 or prosecuted until the final resolution of a proceeding begun as
15 provided in ~~subdivision (b)~~ paragraph (2). Notwithstanding
16 Section 19381, the beginning of that proceeding or levy during the
17 time that prohibition is in force may be enjoined in a proceeding
18 in the superior court.

19 ~~(b)–~~

20 (2) If, within 30 days after the day on which a claim for refund
21 of any partial payment of any penalty under Section 6694(a) or
22 6694(b) of the Internal Revenue Code is denied (or, if earlier,
23 within 30 days after the expiration of six months after the day on
24 which the claim for refund has been filed), the income tax return
25 preparer fails to begin a proceeding in the superior court for the
26 determination of his or her liability for that penalty, ~~subdivision (a)~~
27 ~~paragraph (1)~~ shall cease to apply with respect to that penalty,
28 effective on the day following the close of the applicable 30-day
29 period referred to in this subdivision.

30 ~~(c)–~~

31 (3) The running of the period of limitations provided in Section
32 19371 on the collection by levy or by a proceeding in court in
33 respect of any penalty described in ~~subdivision (a)~~ paragraph (1)
34 shall be suspended for the period during which the Franchise Tax
35 Board is prohibited from collecting by levy or a proceeding in
36 court.

37 SEC. 4. Section 19173 of the Revenue and Taxation Code is
38 amended to read:

39 19173. (a) ~~In addition to the penalty imposed by Section~~
40 ~~19701 (relating to willful failure to file a return or supply~~

1 ~~information), if any~~ A person is liable for a penalty, as determined
2 under subdivision (b), unless it is shown that subdivision (d)
3 applies, if that person is required to file a return under Section
4 18648, Section 19775, or maintain a list under Section 19776, and
5 for any calendar year does any of the following: ~~(1) fails~~
6 (1) Fails to file a return within 60 days of a request, ~~(2) files or~~
7 in the case of a return required to be filed under Section 19775,
8 fails to file the return on or before the date prescribed therefor, or
9 in the case of a list required to be maintained under Section 19776,
10 fails to make that list available upon written request therefor by the
11 Franchise Tax Board.
12 (2) Files a return which fails to show the information required
13 under Section 18648, ~~or (3) fails~~ Section 19775, or in the case of
14 a list required to be maintained under Section 19776, fails to show
15 the information required under Section 19776.
16 (3) Files false or incomplete information with respect to a
17 reportable transaction required to be filed under Section 19775.
18 (4) Fails to furnish the required statement to each investor, ~~that~~
19 ~~person shall be liable for a penalty determined under subdivision~~
20 ~~(b), unless it is shown that such a failure is due to reasonable cause~~
21 ~~investor.~~
22 (b) (1) For purposes of subdivision (a), the amount determined
23 under this subdivision is the product of one thousand dollars
24 (\$1,000), multiplied by the number of investors required to be
25 shown on the return *required to be filed under Section 18648*. If
26 the number of investors cannot be determined by the Franchise Tax
27 Board, the amount determined under this subdivision shall be one
28 hundred thousand dollars (\$100,000).
29 (2) (A) For purposes of subdivision (a), the amount
30 determined under this subdivision for a return required to be filed
31 under Section 19775 shall, except as provided in subparagraph
32 (B), be fifteen thousand dollars (\$15,000).
33 (B) If the penalty is with respect to a listed transaction (as
34 defined in paragraph (2) of subdivision (c) of Section 19772), the
35 amount determined under this subdivision for a return required to
36 be filed under Section 19775 shall be the greater of:
37 (i) Two hundred thousand dollars (\$200,000), or
38 (ii) Fifty percent of the gross income of that material advisor
39 derived from that advice.

(C) *In the case of intentional disregard by a material advisor of the requirement to disclose a listed transaction (as defined in paragraph (2) of subdivision (c) of Section 19772), the percentage of gross income under clause (ii) of subparagraph (B) shall be “75 percent” instead of “50 percent.”*

(3) *For purposes of subdivision (a), the amount determined under this subdivision for the failure to provide a list required to be maintained under Section 19776 at the written request of the Franchise Tax Board shall be ten thousand dollars (\$10,000) for each day after the 20th day that the material advisor has failed to make the list available to the Franchise Tax Board after written request for that list was made by the Franchise Tax Board.*

(c) *The penalty imposed by subdivision (a) shall be assessed against that person required to file a return under Section 18648, Section 19775, or maintain a list under Section 19776.*

(d) (1) *The Chief Counsel of the Franchise Tax Board may rescind all or any portion of any penalty imposed by subdivision (a) with respect to any violation with respect to a return required to be filed under Section 18648, Section 19775, or a list required to be maintained under Section 19776 if all of the following apply:*

(A) *The violation is with respect to a reportable transaction (as defined in paragraph (1) of subdivision (c) of Section 19772) other than a listed transaction (as defined in paragraph (2) of subdivision (c) of Section 19772).*

(B) *The person on whom the penalty is imposed has a history of complying with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).*

(C) *It is shown that the violation is due to an unintentional mistake of fact.*

(D) *Imposing the penalty would be against equity and good conscience.*

(E) *Rescinding the penalty would promote compliance with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001) and effective tax administration.*

(2) *The exercise of authority under paragraph (1) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.*

1 (3) *Notwithstanding any other law or rule of law, any*
2 *determination under this subdivision is final.*

3 (e) Article 3 (commencing with Section 19031) of this chapter
4 (relating to deficiency assessments) ~~shall~~ *does* not apply with
5 respect to the assessment or collection of any penalty imposed by
6 subdivision (a).

7 (f) *The penalty imposed by this section is in addition to any*
8 *penalty imposed under the Personal Income Tax Law (Part 10*
9 *(commencing with Section 17001)), the Corporation Tax Law*
10 *(Part 11 (commencing with Section 23001)), or this part.*

11 SEC. 5. Section 19177 of the Revenue and Taxation Code is
12 amended to read:

13 19177. (a) A penalty shall be imposed for promoting abusive
14 tax shelters. The penalty shall be determined in accordance with
15 the provisions of Section 6700 of the Internal Revenue Code,
16 *except as otherwise provided.*

17 (b) *Notwithstanding Section 6700(a) of the Internal Revenue*
18 *Code, if an activity with respect to which a penalty imposed under*
19 *Section 6700(a) of the Internal Revenue Code involves a statement*
20 *described in Section 6700(a)(2)(A) of the Internal Revenue Code,*
21 *the amount of the penalty imposed under subdivision (a) is equal*
22 *to 50 percent of the gross income derived (or to be derived) from*
23 *that activity by the person on which the penalty is imposed.*

24 SEC. 6. Section 19179 of the Revenue and Taxation Code is
25 amended to read:

26 19179. A penalty ~~shall be~~ is imposed for filing a frivolous
27 return. The penalty shall be determined in accordance with Section
28 6702 of the Internal Revenue Code, ~~except that it shall be applied~~
29 *as otherwise provided.*

30 (a) Section 6702 of the Internal Revenue Code applies to
31 returns required to be filed under this part.

32 (b) Section 6702(a) of the Internal Revenue Code is modified
33 as follows:

34 (1) By substituting “\$5,000” in lieu of “\$500.”

35 (2) By substituting the word “person” in lieu of the phrase
36 “individual” in each place that it appears.

37 (3) By substituting “tax imposed under the Personal Income
38 Tax Law (Part 10 (commencing with Section 17001)), the
39 Corporation Tax Law (Part 11 (commencing with Section 23001)),
40 or this part” in lieu of the phrase “tax imposed by subtitle A.”

1 (4) By substituting the phrase “is based on” in lieu of the
2 phrase “is due to.”

3 (5) By substituting the phrase “frivolous or is based on a
4 position that the Franchise Tax Board has identified as frivolous
5 under subdivision (c) of Section 19179” in lieu of the word
6 “frivolous.”

7 (6) By substituting the phrase “reflects a desire to delay or
8 impede the administration of federal income tax laws as
9 determined by the Secretary of the Treasury or the administration
10 of the tax imposed under the Personal Income Tax Law (Part 10
11 (commencing with Section 17001)), the Corporation Tax Law
12 (Part 11 (commencing with Section 23001)), or this part as
13 determined by the Franchise Tax Board” in lieu of the phrase “a
14 desire (which appears on the purported return) to delay or impede
15 the administration of Federal income tax laws.”

16 (c) (1) The Franchise Tax Board shall prescribe, and
17 periodically revise, a list of positions which the Secretary of the
18 Treasury for federal income tax purposes or the Franchise Tax
19 Board has identified as being frivolous for purposes of this section.

20 (2) Chapter 3.5 (commencing with Section 11340) of Part 1 of
21 Division 3 of Title 2 of the Government Code does not apply to any
22 standard, criterion, procedure, determination, rule, notice, or
23 guideline established or prescribed by the Franchise Tax Board
24 pursuant to paragraph (1).

25 (d) (1) Except as provided in paragraph (3), any person who
26 submits a specified frivolous submission shall pay a penalty of five
27 thousand dollars (\$5,000).

28 (2) For purposes of this section, all of the following apply:

29 (A) The term “specified frivolous submission” means a
30 specified submission if any portion of that submission meets any
31 of the following conditions:

32 (i) Is based on a position that the Franchise Tax Board has
33 identified as frivolous under subdivision (c).

34 (ii) Reflects a desire to delay or impede the administration of
35 federal income tax laws as determined by the Secretary of the
36 Treasury or the administration of the tax imposed under the
37 Personal Income Tax Law (Part 10 (commencing with Section
38 17001)), the Corporation Tax Law (Part 11 (commencing with
39 Section 23001)), or this part as determined by the Franchise Tax
40 Board.

1 (B) The term “specified submission” means any of the
2 following:

3 (i) A protest under Section 19041.

4 (ii) A request for a hearing under Section 19044.

5 (iii) An application under any of the following sections:

6 (I) Section 19008, relating to agreements for payment of tax
7 liability in installments.

8 (II) Section 19443, relating to compromises.

9 (III) Section 21004, relating to actions of the Taxpayer Right’s
10 Advocate.

11 (3) If the Franchise Tax Board provides a person with notice
12 that a submission is a specified frivolous submission and the
13 person withdraws that submission within 30 days after the notice,
14 the penalty imposed under paragraph (1) does not apply with
15 respect to that submission.

16 (e) (1) The Chief Counsel of the Franchise Tax Board may
17 rescind all or any portion of any penalty imposed by this section
18 if both of the following apply:

19 (A) Imposing the penalty would be against equity and good
20 conscience.

21 (B) Rescinding the penalty would promote compliance with the
22 requirements of this part and Part 10 (commencing with Section
23 17001) or Part 11 (commencing with Section 23001) and effective
24 tax administration.

25 (2) The exercise of authority under paragraph (1) shall be at
26 the sole discretion of the Chief Counsel of the Franchise Tax Board
27 and may not be delegated.

28 (3) Notwithstanding any other law or rule of law, any
29 determination under this subdivision is final.

30 (f) The penalties imposed by this section are in addition to any
31 other penalty provided by law.

32 SEC. 7. Section 19715 of the Revenue and Taxation Code is
33 amended to read:

34 19715. (a) A civil action in the name of the State of California
35 to enjoin any person from further engaging in *specified* conduct
36 ~~subject to penalty under Section 19177 (relating to the penalty for~~
37 ~~promoting abusive tax shelters, etc.) or 19178 (relating to penalty~~
38 ~~for aiding and abetting understatement of tax liability)~~ may be
39 commenced at the request of the Franchise Tax Board. Any action
40 under this section shall be brought in accordance with Section

19707. The court may exercise its jurisdiction over that action separate and apart from any other action brought by the State of California against that person.

(b) In any action under subdivision (a), the court may enjoin the person from engaging in the *specified* conduct or in any other activity subject to penalty under ~~Section 19177 or 19178~~ *this part*, if the court finds both of the following:

(1) That the person has engaged in any *specified* conduct subject to penalty under ~~Section 19177 (relating to penalty for promoting abusive tax shelters, etc.) or 19178 (relating to penalty for aiding and abetting understatement of tax liability)~~.

(2) That injunctive relief is appropriate to prevent recurrence of that *specified* conduct.

(c) *For purposes of this section, the term “specified conduct” means any action, or failure to take action, subject to penalty under Sections 19173, 19174, 19177, or 19178.*

SEC. 8. Chapter 9.5 (commencing with Section 19770) is added to Part 10.2 of the Revenue and Taxation Code, to read:

CHAPTER 9.5. TAX SHELTERS

19770. (a) (1) Notwithstanding Section 19057, with respect to proposed deficiency assessments related to an abusive tax avoidance transaction, a notice of a proposed deficiency assessment may be mailed to the taxpayer within eight years after the return was filed, or within the period otherwise provided in Article 3 (commencing with Section 19031) of Chapter 4 of this part, whichever expires later.

(2) For purposes of this section, an “abusive tax avoidance transaction” means a plan or arrangement devised for the principal purpose of avoiding tax. Abusive tax avoidance transactions include, but are not limited to, “listed transactions” as described in Section 19772.

(b) This section applies to any return filed under this part on or after January 1, 2000.

19771. (a) In applying the economic substance doctrine under the Personal Income Tax Law (Part 10 (commencing with Section 17001)), the Corporation Tax Law (Part 11 (commencing with Section 23001)), and this part, the determination of whether

1 a transaction has economic substance shall be made as provided
2 in this section.

3 (b) For purposes of subdivision (a):

4 (1) A transaction has economic substance only if all of the
5 following apply:

6 (A) The transaction changes in a meaningful way (apart from
7 California state income tax effects and, if there is any California
8 state income tax effects, also apart from any federal, foreign, other
9 state, or local tax effects) the taxpayer's economic position.

10 (B) The taxpayer has a substantial nontax purpose for entering
11 into that transaction and the transaction is a reasonable means of
12 accomplishing that purpose.

13 (2) A transaction may not be treated as having economic
14 substance by reason of having a potential for profit, unless both of
15 the following apply:

16 (A) The present value of the reasonably expected pretax profit
17 from the transaction is substantial in relation to the present value
18 of the expected net tax benefits that would be allowed if the
19 transaction were respected.

20 (B) The reasonably expected pretax profit from the transaction
21 exceeds a risk-free rate of return.

22 (c) Fees and other transaction expenses and foreign taxes shall
23 be taken into account as expenses in determining pretax profit
24 under paragraph (2) of subdivision (b).

25 (d) (1) The form of a transaction which is in substance the
26 borrowing of money or the acquisition of financial capital directly
27 or indirectly from a tax-indifferent party may not be respected if the
28 present value of the deductions to be claimed with respect to the
29 transaction is substantially in excess of the present value of the
30 anticipated economic returns of the person lending the money or
31 providing the financial capital. A public offering shall be treated
32 as a borrowing, or an acquisition of financial capital, from a
33 tax-indifferent party if it is reasonably expected that at least 50
34 percent of the offering will be placed with tax-indifferent parties.

35 (2) The form of a transaction with a tax-indifferent party may
36 not be respected if either of the following apply:

37 (A) The form of the transaction results in an allocation of
38 income or gain to the tax-indifferent party in excess of such party's
39 economic income or gain.



1 (B) *The form of the transaction results in a basis adjustment or*
2 *shifting of basis on account of overstating the income or gain of the*
3 *tax-indifferent party.*

4 (e) *For purposes of this subsection:*

5 (1) *The term “economic substance doctrine” means the*
6 *common law doctrine under which tax benefits under the Personal*
7 *Income Tax Law (Part 10 (commencing with Section 17001)) or*
8 *the Corporation Tax Law (Part 11 (commencing with Section*
9 *23001)) with respect to a transaction are not allowable if the*
10 *transaction does not have economic substance or lacks a business*
11 *purpose.*

12 (2) *The term “tax-indifferent party” means any person or entity*
13 *not subject to tax imposed by Part 10 (commencing with Section*
14 *17001) or Part 11 (commencing with Section 23001) including an*
15 *entity not subject to tax imposed under Part 11 pursuant to a*
16 *water’s-edge election under Article 1.5 (commencing with 25110)*
17 *of Chapter 17 of Part 11. A person is treated as a tax-indifferent*
18 *party with respect to a transaction if the items taken into account*
19 *with respect to the transaction have no substantial impact on that*
20 *person’s liability under Part 10 (commencing with Section 17001)*
21 *or Part 11 (commencing with Section 23001).*

22 (3) *In applying subparagraph (A) of paragraph (2) of*
23 *subdivision (b) to the lessor of tangible property subject to a lease,*
24 *the expected net tax benefits may not include the benefits of*
25 *depreciation, or any tax credit, with respect to the leased property*
26 *and subparagraph (B) of paragraph (2) of subdivision (b) shall be*
27 *disregarded in determining whether any of those benefits are*
28 *allowable.*

29 (f) *Except as specifically provided in this section, the provisions*
30 *of this section may not be construed as altering or supplanting any*
31 *other rule of law, and the requirements of this section shall be*
32 *construed as being in addition to any other rule of law.*

33 (g) (1) *The Franchise Tax Board may prescribe those*
34 *regulations as may be necessary or appropriate to carry out the*
35 *purposes of this section. The regulations may include exemptions*
36 *from the application of this section.*

37 (2) *Any regulations promulgated by the Secretary of the*
38 *Treasury related to economic substance shall be applicable for*
39 *purposes of this section to the extent they do not conflict with this*
40 *part or with regulations issued by the Franchise Tax Board.*

1 (h) This section applies to determinations on or after the
2 effective date of this act with respect to transactions entered into
3 on or after January 1, 1999.

4 19772. (a) Any person who fails to include on any return or
5 statement any information with respect to a reportable transaction
6 that is required under Section 6011 of the Internal Revenue Code,
7 as modified by Section 18407, to be included with that return or
8 statement shall pay a penalty in the amount determined under
9 subdivision (b).

10 (b) (1) Except as provided in paragraphs (2) and (3), the
11 amount of the penalty under subdivision (a) is fifteen thousand
12 dollars (\$15,000).

13 (2) The amount of the penalty under subdivision (a) with
14 respect to a listed transaction is thirty thousand dollars (\$30,000).

15 (3) (A) In the case of a failure under subdivision (a) by a large
16 entity, or by a high net worth individual, the penalty under
17 paragraph (1) or (2) shall be twice the amount determined without
18 regard to this paragraph.

19 (B) For purposes of subparagraph (A), the term “large entity”
20 means, with respect to any taxable year, a person (other than an
21 individual) with gross receipts in excess of ten million dollars
22 (\$10,000,000) for the taxable year in which the reportable
23 transaction occurs or the preceding taxable year. Rules similar to
24 the rules of Sections 448(c)(2) and 448(c)(3) of the Internal
25 Revenue Code, other than Section 448(c)(3)(A) of the Internal
26 Revenue Code, apply for purposes of this subparagraph.

27 (C) The term “high net worth individual” means, with respect
28 to a transaction, an individual whose net worth exceeds two
29 million dollars (\$2,000,000) immediately before the transaction.

30 (c) For purposes of this section:

31 (1) The term “reportable transaction” means any transaction
32 with respect to which information is required to be included with
33 a return or statement because, as determined under regulations
34 prescribed by the Secretary of the Treasury under Section 6011 of
35 the Internal Revenue Code for federal income tax purposes or by
36 the Franchise Tax Board under Section 18407, that transaction is
37 of a type that the Secretary of the Treasury for federal income tax
38 purposes or the Franchise Tax Board determines as having a
39 potential for tax avoidance or evasion.

(2) Except as provided in regulations prescribed by the Secretary of the Treasury or by the Franchise Tax Board, the term “listed transaction” means a reportable transaction (as defined in paragraph (1)) that is the same as, or substantially similar to, a transaction specifically identified by the Secretary of the Treasury for purposes of Section 6011 of the Internal Revenue Code for federal income tax purposes or by the Franchise Tax Board for purposes of Section 6011 of the Internal Revenue Code or Section 18407, as a tax avoidance transaction.

(d) (1) The Chief Counsel of the Franchise Tax Board may rescind all or any portion of any penalty imposed by this section with respect to any violation if all of the following apply:

(A) The violation is with respect to a reportable transaction other than a listed transaction.

(B) The person on whom the penalty is imposed has a history of complying with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).

(C) It is shown that the violation is due to an unintentional mistake of fact.

(D) Imposing the penalty would be against equity and good conscience.

(E) Rescinding the penalty would promote compliance with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001) and effective tax administration.

(2) The exercise of authority under paragraph (1) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(3) Notwithstanding any other law or rule of law, any determination under this subdivision is final.

(e) Article 3 (commencing with Section 19031) of Chapter 4 (relating to deficiency assessments) does not apply with respect to the assessment or collection of any penalty imposed under this section.

(f) The penalty imposed by this section is in addition to any penalty imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part.

19773. (a) If a taxpayer has a reportable transaction understatement for any taxable year, there shall be added to the tax

1 *an amount equal to 20 percent of the amount of that*
2 *understatement.*

3 *(b) For purposes of this section, both of the following apply:*

4 *(1) The term “reportable transaction understatement” means*
5 *the sum of subparagraphs (A) and (B).*

6 *(A) The product of:*

7 *(i) The amount of the increase (if any) in taxable income which*
8 *results from a difference between the proper tax treatment of an*
9 *item to which this section applies and the taxpayer’s treatment of*
10 *that item (as shown on the taxpayer’s return of tax).*

11 *(ii) The highest rate of tax imposed on the taxpayer under Part*
12 *10 (commencing with Section 17001) in the case of a taxpayer*
13 *subject to tax under that part or under Part 11 (commencing with*
14 *Section 23001) in the case of a taxpayer that is subject to tax under*
15 *that part.*

16 *(B) The amount of the decrease (if any) in the aggregate*
17 *amount of credits determined under Part 10 (commencing with*
18 *Section 17001) or Part 11 (commencing with Section 23001), as*
19 *applicable, that results from a difference between the taxpayer’s*
20 *treatment of an item to which this section applies, as shown on the*
21 *taxpayer’s return of tax, and the proper tax treatment of that item.*

22 *(C) For purposes of subparagraph (A), any reduction of the*
23 *excess of deductions allowed for the taxable year over gross*
24 *income for that year, and any reduction in the amount of capital*
25 *losses which would, without regard to Section 1211 of the Internal*
26 *Revenue Code, be allowed for that year, shall be treated as an*
27 *increase in taxable income.*

28 *(2) This section applies to any item that is attributable to either*
29 *of the following:*

30 *(A) Any listed transaction.*

31 *(B) Any reportable transaction, other than a listed transaction,*
32 *if a significant purpose of that transaction is the avoidance or*
33 *evasion of tax imposed under Part 10 (commencing with Section*
34 *17001) or Part 11 (commencing with Section 23001).*

35 *(c) (1) Subdivision (a) shall be applied by substituting “30*
36 *percent” for “20 percent” with respect to the portion of any*
37 *reportable transaction understatement with respect to which the*
38 *requirement of Section 6664 of the Internal Revenue Code, as*
39 *modified by subparagraph (A) of paragraph (2) of subdivision (d)*
40 *of Section 19164, is not met.*

1 (2) (A) *If the notice of proposed assessment of additional tax*
2 *has been sent with respect to a penalty to which this section*
3 *applies, only the Chief Counsel of the Franchise Tax Board may*
4 *compromise all or any portion of that penalty.*

5 (B) *The exercise of authority under subparagraph (A) shall be*
6 *at the sole discretion of the Chief Counsel of the Franchise Tax*
7 *Board and may not be delegated.*

8 (C) *Notwithstanding any other law or rule of law, any*
9 *determination under this subdivision may not be reviewed in any*
10 *administrative or judicial proceeding.*

11 (d) *For purposes of this section, the terms “reportable*
12 *transaction” and “listed transaction” have the respective*
13 *meanings given to those terms by subdivision (c) of Section 19772.*

14 (e) (1) *In the case of an understatement (as defined in Section*
15 *6662(d)(2) of the Internal Revenue Code) all of the following*
16 *apply:*

17 (A) *The amount of the understatement, determined without*
18 *regard to this paragraph, shall be increased by the aggregate*
19 *amount of reportable transaction understatements and*
20 *noneconomic substance transaction understatements for purposes*
21 *of determining whether the understatement is a substantial*
22 *understatement under Section 6662(d)(1) of the Internal Revenue*
23 *Code.*

24 (B) *The addition to tax under subdivision (a) of Section 19164*
25 *applies only to the excess of the amount of the substantial*
26 *understatement, if any, after the application of subparagraph (A)*
27 *over the aggregate amount of reportable transaction*
28 *understatements and noneconomic substance transaction*
29 *understatements.*

30 (2) (A) *In determining the fraud penalty imposed under*
31 *subdivision (c) of Section 19164, references to an underpayment*
32 *in Section 6663 of the Internal Revenue Code are treated as*
33 *including references to a reportable transaction understatement*
34 *and a noneconomic substance transaction understatement.*

35 (B) *This section does not apply to any portion of an*
36 *understatement on which a penalty is imposed under Section*
37 *19774.*

38 (3) *Except as provided in regulations, in no event may any tax*
39 *treatment included with an amendment or supplement to a return*
40 *of tax be taken into account in determining the amount of any*

1 reportable transaction understatement or noneconomic substance
2 transaction understatement, if the amendment or supplement is
3 filed after the earlier of the date the taxpayer is first contacted by
4 either the Secretary of the Treasury for federal income tax purposes
5 or the Franchise Tax Board regarding the examination of the
6 return or such other date as is specified by the Franchise Tax
7 Board.

8 (4) For purposes of this subdivision, the term “noneconomic
9 substance transaction understatement” has the meaning given
10 that term by subdivision (c) of Section 19774.

11 19774. (a) If a taxpayer has a noneconomic substance
12 transaction understatement for any taxable year, there shall be
13 added to the tax an amount equal to 40 percent of the amount of
14 that understatement.

15 (b) (1) Subdivision (a) shall be applied by substituting “20
16 percent” for “40 percent” with respect to the portion of any
17 noneconomic substance transaction understatement with respect
18 to which the relevant facts affecting the tax treatment of the item
19 are adequately disclosed in the return or a statement attached to
20 the return.

21 (2) For taxable years beginning before January 1, 2003,
22 “adequately disclosed” includes the disclosure of the tax shelter
23 identification number on the taxpayer’s return as required by
24 subdivision (c) of Section 18628.

25 (c) (1) The term “noneconomic substance transaction
26 understatement” means any amount which would be an
27 understatement under paragraph (1) of subdivision (b) of Section
28 19773 if Section 19773 were applied by taking into account items
29 attributable to noneconomic substance transactions rather than
30 items to which Section 19773 applies.

31 (2) The term “noneconomic substance transaction” means any
32 transaction if either of the following conditions are satisfied:

33 (A) There is a lack of economic substance (within the meaning
34 of Section 19771) for the transaction giving rise to the claimed
35 benefit or the transaction was not respected under Section 19771.

36 (B) The transaction fails to meet the requirements of any
37 similar rule of law.

38 (d) (1) If the notice of proposed assessment of additional tax
39 has been sent with respect to a penalty to which this section

1 *applies, only the Chief Counsel of the Franchise Tax Board may*
2 *compromise all or any portion of that penalty.*

3 *(2) The exercise of authority under paragraph (1) shall be at*
4 *the sole discretion of the Chief Counsel of the Franchise Tax Board*
5 *and may not be delegated.*

6 *(3) Notwithstanding any other law or rule of law, any*
7 *determination under this subdivision is final.*

8 *19775. In addition to the requirements of Section 18628, all*
9 *of the following requirements apply:*

10 *(a) (1) Each material advisor with respect to any reportable*
11 *transaction shall make a return, in the form the Franchise Tax*
12 *Board may by forms and instructions prescribe, setting forth all of*
13 *the following:*

14 *(A) Information identifying and describing the transaction.*

15 *(B) Information describing any potential tax benefits expected*
16 *to result from the transaction.*

17 *(C) Any other information as the Franchise Tax Board may by*
18 *forms and instructions prescribe.*

19 *(2) The return required under paragraph (1) shall be filed not*
20 *later than the date specified by the Franchise Tax Board.*

21 *(b) For purposes of this section:*

22 *(1) (A) The term “material advisor” means any person that*
23 *satisfies both of the following requirements:*

24 *(i) Provides any material aid, assistance, or advice with respect*
25 *to organizing, promoting, selling, implementing, or carrying out*
26 *any reportable transaction.*

27 *(ii) Directly or indirectly derives gross income in excess of the*
28 *threshold amount for that aid, assistance, or advice.*

29 *(B) For purposes of subparagraph (A), the threshold amount is*
30 *fifty thousand dollars (\$50,000) in the case of a reportable*
31 *transaction, from which substantially all of the tax benefits are*
32 *provided to individuals, and two hundred fifty thousand dollars*
33 *(\$250,000) in any other case.*

34 *(2) The term “reportable transaction” has the meaning given*
35 *to that term by paragraph (1) of subdivision (c) of Section 19772.*

36 *(c) The Franchise Tax Board may by forms and instructions*
37 *prescribe all of the following:*

38 *(1) That only one person shall be required to meet the*
39 *requirements of subdivision (a) in cases in which two or more*
40 *persons would otherwise be required to meet those requirements.*

1 (2) *Exemptions from the requirements of this section.*

2 (3) *Those rules as may be necessary or appropriate to carry out*
3 *the purposes of this section.*

4 19776. (a) *Each material advisor, as defined in Section*
5 *19775, with respect to any reportable transaction, as defined in*
6 *paragraph (1) of subdivision (c) of Section 19772, shall maintain,*
7 *in the form and manner as the Franchise Tax Board may by forms*
8 *and instructions prescribe, a list that provides all of the following*
9 *information:*

10 (1) *Identification of each person with respect to whom the*
11 *material advisor acted as a material advisor with respect to a*
12 *reportable transaction, as defined in paragraph (1) of subdivision*
13 *(c) of Section 19772. That identification shall include for each*
14 *person listed, the full name, address, and taxpayer identification*
15 *number of that person.*

16 (2) *Any other information the Franchise Tax Board may*
17 *require.*

18 (b) *Every person required to maintain a list under subdivision*
19 *(a) shall make that list available to the Franchise Tax Board within*
20 *20 days of a written request for that list made by the Franchise Tax*
21 *Board. Every person required to maintain a list under subdivision*
22 *(a) shall furnish, within 20 days of the date the list is furnished to*
23 *the Franchise Tax Board under the preceding sentence, to each*
24 *person with respect to whom the material advisor acted as a*
25 *material advisor with respect to a reportable transaction, as*
26 *defined in paragraph (1) of subdivision (c) of Section 19772, and*
27 *that is shown on that list, a written statement showing the name,*
28 *address, and telephone number of the person furnishing the list to*
29 *the Franchise Tax Board as well as a description of the information*
30 *provided.*

31 (c) *This section applies without regard to whether a material*
32 *advisor is required to file a return under Section 19775 with respect*
33 *to a reportable transaction, as defined in paragraph (1) of*
34 *subdivision (c) of Section 19772.*

35 19777. (a) *If a taxpayer has been contacted by the Franchise*
36 *Tax Board regarding the use of a potentially abusive tax shelter*
37 *and has an underpayment of tax, there shall be added to the tax an*
38 *amount equal to 100 percent of the interest accrued under Section*
39 *19101 for the period beginning on the last date prescribed by law*
40 *for the payment of that tax, determined without regard to*

1 extensions, and ending on the date the notice of proposed
2 assessment is mailed.

3 (b) “Potentially abusive tax shelter” means:

4 (1) Any tax shelter, as defined in Section 6111 of the Internal
5 Revenue Code, with respect to which registration is required under
6 Section 6111 of the Internal Revenue Code.

7 (2) Any entity, investment plan or arrangement, or other plan
8 or arrangement which is of a type that the Secretary or the
9 Franchise Tax Board determines by regulations as having a
10 potential for tax avoidance or evasion.

11 (c) The penalty imposed by this section is in addition to any
12 other penalty imposed under Part 10 (commencing with Section
13 17001), Part 11 (commencing with Section 23000), or this part.

14 (d) This section applies to notices of proposed assessments
15 mailed after the effective date of the act adding this section.

16 19778. For any amended return filed after March 31, 2004,
17 and before the taxpayer is contacted by the Internal Revenue
18 Service or the Franchise Tax Board regarding a potentially
19 abusive tax shelter, then, for taxable years beginning after
20 December 31, 1998, with respect to any understatement of tax
21 related to using reportable transactions as defined in Section
22 18407, as added by the act adding this section, the taxpayer is
23 subject to interest as provided under Section 19101 but at a rate
24 of 150 percent of the adjusted annual rate established under
25 Section 19521.

26 SEC. 9. Section 21028 of the Revenue and Taxation Code is
27 amended to read:

28 21028. (a) (1) With respect to tax advice, the protections of
29 confidentiality that apply to a communication between a client and
30 an attorney, as set forth in Article 3 (commencing with Section
31 950) of Chapter 4 of Division 8 of the Evidence Code, shall also
32 apply to a communication between a taxpayer and any federally
33 authorized tax practitioner to the extent the communication would
34 be considered a privileged communication if it were between a
35 client and an attorney.

36 (2) Paragraph (1) may only be asserted in any noncriminal tax
37 matter before the Franchise Tax Board.

38 (3) For purposes of this section:

39 (A) “Federally authorized tax practitioner” means any
40 individual who is authorized under federal law to practice before

1 the Internal Revenue Service if the practice is subject to federal
2 regulation under Section 330 of Title 31 of the United States Code,
3 as provided by federal law as of January 1, 2000.

4 (B) "Tax advice" means advice given by an individual with
5 respect to a state tax matter, which may include federal tax advice
6 if it relates to the state tax matter. For purposes of this
7 subparagraph, "federal tax advice" means advice given by an
8 individual within the scope of his or her authority to practice
9 before the federal Internal Revenue Service on noncriminal tax
10 matters.

11 (C) "Tax shelter" means a partnership or other entity, any
12 investment plan or arrangement, or any other plan or arrangement
13 if a significant purpose of that partnership, entity, plan, or
14 arrangement is the avoidance or evasion of federal income tax *or*
15 *the avoidance or evasion of the tax imposed under the Personal*
16 *Income Tax Law (Part 10 (commencing with Section 17001)) or*
17 *the Corporation Tax Law (Part 11 (commencing with Section*
18 *23001))*.

19 (b) The privilege under subdivision (a) ~~shall~~ *does not* apply to
20 any written communication between a federally authorized tax
21 practitioner and ~~a any person, or any director, shareholder, officer,~~
22 ~~or employee, agent, or representative of a corporation person, or~~
23 *any other person holding a capital or profits interest in the person*
24 *in connection with the promotion of the direct or indirect*
25 *participation of the person in any tax shelter, as defined in Section*
26 *1274(b)(3)(B) of the Internal Revenue Code, as modified by*
27 *subdivision (g) of Section 19164, in connection with the promotion*
28 *of the direct or indirect participation of the corporation in any tax*
29 *shelter, or in any proceeding to revoke or otherwise discipline any*
30 *license or right to practice by any governmental agency.*

31 (c) This section shall be operative for communications made on
32 or after the effective date of the act adding this section.

33 (d) This section shall remain in effect only until January 1,
34 2005, and as of that date is repealed, unless a later enacted statute,
35 that is enacted before January 1, 2005, deletes or extends that date.

36 (e) *The amendments to this section by the act adding this*
37 *subdivision shall apply to communications made on or after the*
38 *effective date of the act adding this subdivision.*

39 SEC. 10. (a) *This act shall apply with respect to any penalty*
40 *assessed on or after January 1, 2004, on any return on which the*

1 statute of limitations on assessment has not expired, unless
2 provided otherwise. All other provisions of this act shall apply on
3 January 1, 2004.

4 (b) Except as provided in subdivision (c), Sections 18407,
5 19772, and 19773 of the Revenue and Taxation Code, as amended
6 or added by this act, apply to taxable years beginning on or after
7 January 1, 2003.

8 (c) (1) Sections 19775 and 19776 of the Revenue and Taxation
9 Code, as added by this act, apply beginning on January 1, 1999.

10 (2) For persons to which Sections 19775 or 19776 apply,
11 Sections 18407 and 19772 of the Revenue and Taxation Code, as
12 amended or added by this act, apply beginning on January 1, 1999.

13 (3) For purposes of applying Section 19778 of the Revenue and
14 Taxation Code, Section 18407 of the Revenue and Taxation Code,
15 as added by this act, applies for taxable years beginning after
16 December 31, 1998.

17 (4) For the period January 1, 1999, through December 31,
18 2003, the return required under Section 19775 or the list required
19 under Section 19776 of the Revenue and Taxation Code, as added
20 by this act, may not be due or requested prior to April 30, 2004.

21 Code is amended to read:

22 ~~18628. (a) Any person required to register a tax shelter with~~
23 ~~the Secretary of the Treasury under Section 6111 of the Internal~~
24 ~~Revenue Code is required, if that tax shelter is a California tax~~
25 ~~shelter, to send a duplicate of that registration information to the~~
26 ~~Franchise Tax Board not later than the day on which the tax shelter~~
27 ~~is treated as a California tax shelter.~~

28 ~~(b) Any person required to register under Section 6111 of the~~
29 ~~Internal Revenue Code who receives a tax registration number~~
30 ~~from the Secretary of the Treasury shall, within 30 days after~~
31 ~~request by the Franchise Tax Board, file a statement of that~~
32 ~~registration number.~~

33 ~~(c) Section 6111(b) of the Internal Revenue Code, relating to~~
34 ~~inclusion of tax shelter identification numbers on returns, applies.~~

35 ~~(d) For purposes of this section, the term "California tax~~
36 ~~shelter" means a tax shelter that satisfies any of the following:~~

37 ~~(1) It is organized in this state.~~

38 ~~(2) It is doing business in this state.~~

39 ~~(3) It is deriving income from sources in this state.~~

40 ~~(4) One of its investors is a California taxpayer.~~

1 ~~(5) It solicits investments from California taxpayers.~~

2 ~~SEC. 2. Section 19057 of the Revenue and Taxation Code is~~
3 ~~amended to read:~~

4 ~~19057. (a) (1) Except in the case of a false or fraudulent~~
5 ~~return and except as otherwise expressly provided in this part,~~
6 ~~every notice of a proposed deficiency assessment shall be mailed~~
7 ~~to the taxpayer within four years after the return was filed. No~~
8 ~~deficiency shall be assessed or collected with respect to the year~~
9 ~~for which the return was filed unless the notice is mailed within the~~
10 ~~four-year period or the period otherwise provided. For purposes of~~
11 ~~this chapter, the term "return" means the return required to be~~
12 ~~filed by the taxpayer and does not include a return of any person~~
13 ~~from whom the taxpayer has received an item of income, gain,~~
14 ~~loss, deduction, or credit.~~

15 ~~(2) (A) Notwithstanding paragraph (1), in the case of a return~~
16 ~~filed by a taxpayer who is an investor in a tax shelter, as defined~~
17 ~~in subparagraph (B), every notice of a proposed deficiency~~
18 ~~assessment shall be mailed to the taxpayer within eight years after~~
19 ~~the return is filed. No deficiency shall be assessed or collected with~~
20 ~~respect to the year for which the return was filed unless the notice~~
21 ~~is mailed within the eight year period.~~

22 ~~(B) For purposes of this section, "tax shelter" means a~~
23 ~~partnership or other entity, any investment plan or arrangement, or~~
24 ~~any other plan or arrangement, if a significant purpose of that~~
25 ~~partnership, entity, plan, or arrangement is the avoidance or~~
26 ~~evasion of federal or state, or both federal and state, income tax.~~

27 ~~(C) This paragraph shall apply to any return filed on or after~~
28 ~~January 1, 2000.~~

29 ~~(b) The running of the period of limitations provided in~~
30 ~~subdivision (a) on mailing a notice of proposed deficiency~~
31 ~~assessment shall, in a case under Title 11 of the United States Code,~~
32 ~~be suspended for any period during which the Franchise Tax Board~~
33 ~~is prohibited by reason of that case from mailing the notice of~~
34 ~~proposed deficiency assessment and for 60 days thereafter.~~

35 ~~(c) Where, within the 60-day period ending on the day on~~
36 ~~which the time prescribed in this section for the assessment of any~~
37 ~~tax imposed under Part 10 (commencing with Section 17001) or~~
38 ~~Part 11 (commencing with Section 23001) for any taxable year~~
39 ~~would otherwise expire, the Franchise Tax Board receives a~~
40 ~~written document, other than an amended return or a report~~

1 required by Section 18622, signed by the taxpayer showing that
2 the taxpayer owes an additional amount of that tax for that taxable
3 year, the period for the assessment of an additional amount in
4 excess of the amount shown on either an original or amended
5 return shall not expire before the day 60 days after the day on
6 which the Franchise Tax Board receives that document.

7 (d) If a taxpayer determines in good faith that it is an exempt
8 organization and files a return as an exempt organization under
9 Section 23772, and if the taxpayer is thereafter held to be a taxable
10 organization for the taxable year for which the return is filed, that
11 return shall be deemed the return of the organization for the
12 purposes of this section.

13 SEC. 3. Section 19164 of the Revenue and Taxation Code is
14 amended to read:

15 19164. (a) (1) An accuracy-related penalty shall be imposed
16 under this part and shall be determined in accordance with the
17 provisions of Section 6662 of the Internal Revenue Code, relating
18 to imposition of accuracy-related penalty, except as otherwise
19 provided in paragraph (3).

20 (2) With respect to corporations, this subdivision shall apply to
21 all of the following:

22 (A) All taxable years beginning on or after January 1, 1990.

23 (B) Any other taxable year for which an assessment is made
24 after July 16, 1991.

25 (C) For purposes of this section, references in Section 6662(e)
26 of the Internal Revenue Code and the regulations thereunder,
27 relating to treatment of an affiliated group that files a consolidated
28 federal return, are modified to apply to those entities required to
29 be included in a combined report under Section 25101 or 25110.
30 For these purposes, entities included in a combined report pursuant
31 to paragraph (4) or (6) of subdivision (a) of Section 25110 shall be
32 considered only to the extent required to be included in the
33 combined report.

34 (3) (A) With respect to a taxpayer who is an investor in a tax
35 shelter, Section 6662(a) of the Internal Revenue Code is modified
36 by substituting "50 percent" in lieu of "20 percent."

37 (B) For purposes of this section, "tax shelter" means a
38 partnership or other entity, any investment plan or arrangement, or
39 any other plan or arrangement, if a significant purpose of that

1 partnership, entity, plan, or arrangement is the avoidance or
2 evasion of federal, state, or both federal and state, income tax.

3 (b) The modifications to Section 6662 of the Internal Revenue
4 Code by Public Law 103-66 and Public Law 103-465 shall apply
5 with respect to returns filed for taxable years beginning on or after
6 January 1, 1997.

7 (c) A fraud penalty shall be imposed under this part and shall
8 be determined in accordance with the provisions of Section 6663
9 of the Internal Revenue Code, relating to imposition of fraud
10 penalty.

11 (d) The provisions of Section 6664 of the Internal Revenue
12 Code, relating to definitions and special rules, shall apply.

13 (e) The provisions of Section 6665 of the Internal Revenue
14 Code, relating to applicable rules, shall apply.

15 SEC. 4. Section 19177 of the Revenue and Taxation Code is
16 amended to read:

17 19177. (a) A penalty shall be imposed for promoting abusive
18 tax shelters. The penalty shall be determined in accordance with
19 the provisions of Section 6700 of the Internal Revenue Code, as
20 modified by subdivision (b).

21 (b) Section 6700(a)(2) of the Internal Revenue Code is
22 modified by substituting the phrase "25 percent of the aggregate
23 amount invested by all investors in such entity or arrangement
24 referred to in subparagraph (A)" in lieu of the phrase "the \$1,000
25 or, if the person establishes that it is lesser, 100 percent of the gross
26 income derived (or to be derived) by such person from such
27 activity."

28 SEC. 4. Section 19182 of the Revenue and Taxation Code is
29 amended to read:

30 19182. (a) (1) A penalty shall be imposed for failure to
31 furnish information pursuant to Section 18628 and the penalty
32 shall be determined in accordance with Section 6707 of the
33 Internal Revenue Code, as modified in paragraph (2).

34 (2) Section 6707(a)(2) of the Internal Revenue Code is
35 modified by substituting the phrase "25 percent of the aggregate
36 amount invested in such tax shelter" in lieu of the phrase "the
37 greater of (A) 1 percent of the aggregate amount invested in such
38 tax shelter, or (B) \$500."

39 (b) If the person required to register the tax shelter has
40 complied, for federal purposes, with the requirements of Section

1 ~~6111(d) of the Internal Revenue Code, relating to certain~~
2 ~~confidential arrangements treated as tax shelters, the person~~
3 ~~required to register the tax shelter shall be deemed to have~~
4 ~~complied with the requirements of Section 18628 for purposes of~~
5 ~~this part and no penalty shall be imposed under subdivision (a):~~

6 ~~(e) Article 3 (commencing with Section 19031) of this chapter~~
7 ~~(relating to deficiency assessments) shall not apply in respect of~~
8 ~~the assessment or collection of any penalty imposed under this~~
9 ~~section.~~

10 ~~SEC. 5. If any phrase, clause, sentence, or provision of~~
11 ~~Section 1 of this bill is declared to be contrary to the constitution~~
12 ~~of any state or of the United States, or the applicability thereof to~~
13 ~~any government, agency, person, or circumstance is held invalid,~~
14 ~~the validity of the remainder of this bill and the applicability~~
15 ~~thereof to any other government, agency, person, or circumstance~~
16 ~~shall not be affected thereby.~~

